Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

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Bill Number: SB 1639

Related Bills: See Prior Analysis
Telephone: 845-4624
Amended Date: April 17, 2006

Attorney: Patrick Kusiak
Sponsor: ______

SUBJECT: Employer Provided Health Insurance Credit/FTB Report To Legislature On Or Before September 1, 2010, On Usage Of Credit

_____ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended __________________.

_____ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

_____ AMENDMENTS DID NOT RESOLVE THE DEPARTMENTS CONCERNS stated in the previous analysis of bill as introduced/amended ____________________.

_____ FURTHER AMENDMENTS NECESSARY.

_____ DEPARTMENT POSITION CHANGED TO ____________________.

_____ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED/AMENDED ________________________ STILL APPLIES.

__X__ OTHER – See comments below.

SUMMARY

This bill would create a tax credit for taxpayers that contribute to Health Savings Accounts (HSAs) on behalf of their employees.

SUMMARY OF AMENDMENTS

The April 17, 2006, amendments added language that would limit the credit to employers who contribute to HSAs on behalf of employees who perform services in California.

As a result of the amendments, the “THIS BILL” portion of the analysis, as introduced February 24, 2006, has been revised. The “Revenue Estimate” and “Revenue Discussion” have also been revised to reflect the impact of the amendments. The department’s implementation consideration regarding having employees in more than one state has been resolved. The remainder of the analysis of the bill as introduced February 24, 2006, still applies.

Board Position:			Legislative Director	Date
_______ S	_______ NA	_______ NP		
_______ SA	_______ O	_______ NAR	Brian Putler	5/2/06
_______ N	_______ OUA	___X___ PENDING		

THIS BILL

This bill would allow a 15% credit for amounts paid during the taxable year by a taxpayer that makes a contribution to a Health Savings Account (HSA) on behalf of its employees who perform services in California. The credit would be available for taxable years beginning on or after January 1, 2007, and before January 1, 2012.

This bill would specify the following:

- No deduction would be allowed for the same expenses for which the credit was allowed.
- Unused credits can be carried over to future years until the credit is exhausted.
- Franchise Tax Board would be required to provide a report on the usage of this credit to the Legislature on or before September 1, 2010
- Legislative Analyst would be required to provide a report to the Legislature on the effectiveness of the tax credit on or before March 1, 2011.

This bill would allow the credit to Personal Income Tax (PIT) taxpayers and Corporation Tax Law (CTL) taxpayers.

ECONOMIC IMPACT

Revenue Estimate

The revenue impact of this measure, under the assumptions discussed below, is estimated to be as follows:

Revenue Impact of SB 1639 Enactment Assumed After June 30, 2006 (in Millions)			
	2006-7	2007-8	2008-9
Revenue Impact	-$.50	-$3	-$5

This analysis does not account for changes in employment, personal income, or gross state product that could result from this measure.

Revenue Discussion

The assumptions and parameters included in the estimates are based on state employment data from the Employment Development Department (EDD), information from industry experts, and literature related to the U.S. and California health care industry.

Based on surveys published by the health care industry, it was estimated that on average 18% of employees in small firms (2 to 199 employees) and 8% in large firms receive high-deductible insurance from their employers. Based on these percentages and EDD employment data, the number of employees with high-deductible insurance is projected to be about 2,300,000 for 2007. Only 85% of these, or about 1,955,000 employees, were assumed to work in taxable organizations. It is assumed that 2% of these employees, or about 39,000, would receive employer contributions to health savings account (HSA) because of the incentive effect of the proposal. Employer contributions to HSAs were assumed to average $1,200 per year per employee in 2007. This amount was grown at a rate of 5% per year after 2007. It was estimated that a total of $47 million of employer contributions would be made in 2007. With a credit rate of 15%, this translates into $7 million of potential tax credit. Approximately 55% of this amount, or about $4 million, was projected to be used due to sufficient tax liability. The unused credits would be carried forward until exhausted.

Since the credit is in lieu of a deduction for compensation, employers would lose deductions in the amount of $47 million. Using an estimated tax rate of 6.5 % for employers leads to an offsetting revenue impact of $3 million. The net revenue impact of the proposal for this group of employees is projected to be $1 million.

Based on the same data, the number of employees without any insurance in 2007 is projected to be about 2,200,000 of whom 85%, or 1,840,000, work in taxable organizations. It was assumed that 1% of employees in small firms and 0.5% in large firms would receive high deductible insurance plans with employer contributions. This would result in 18,000 (0.01 × 1,797,000) + (0.005 × 44,000) California employees. For this group, employers would pay the insurance premiums as well as contribute $1,200 per year to employee HSAs. The contributions to HSAs would amount to about $22 million ($1,200 × 18,000) resulting in $3 million potential tax credit at 15%. Of this amount only 70% or $2 million would be used due to sufficient tax liability. Unused credits would be carried forward until exhausted. The offsetting deductions were estimated to be about $1 million so that the net of credits revenue impact equals $1 million.

The average monthly premium cost for HMOs for 2004 was about $260. The average premium for high-deductible health insurance was assumed to be about half of this amount or $130 per month. A 10% annual growth rate was assumed for the premiums. This resulted in an estimated annual premium of about $2,000 for 2007 ($130 per month × 12 months × growth factor of 1.33 for three years from 2004 to 2007). Assuming a tax rate of 5% for the employees would result in $3 million of tax revenue impact of these offsetting deductions. The total revenue impact of the proposal for this group of employees would therefore amount to about $4 ($3 million + $1 million). The total revenue impact of the proposal was estimated to be about $8 million for 2007, ($4 million of revenue impact for this group + $4 million for the previous group = $8 million).

LEGAL IMPACT

If this bill requires taxpayers to provide health insurance to employees located within or residents of California in order for the costs to qualify for this credit, the credit may be subject to constitutional challenge. The U.S. Court of Appeals for the 6th Circuit ruled in *Cuno v. DaimlerChrysler, Inc.* (2004) 386 F. 3d 738, that Ohio's Investment Tax Credit is unconstitutional because it gives improper preferential treatment to companies to locate or expand in Ohio rather than in other states and, therefore, violates the Commerce Clause of the U.S. Constitution. This case is now pending with the U.S. Supreme Court. The Court will issue its decision on this case by the end of June, 2006. Although the outcome of this decision and its effects on the income tax credits of other states, including California, is unknown, targeted tax incentives that are conditioned on activities in California may be subject to constitutional challenge.

POLICY CONCERNS

This bill leaves the number of years for the carryover period unlimited. Consequently, the department would be required to retain the carryover on the tax forms indefinitely. Recent credits have been enacted with a carryover period limit since experience shows credits typically are exhausted within eight years of being earned.

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